

*Cement Companies – Stable Credit Profile  
In a challenging environment*

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**Sector Overview**

The credit profile of cement companies have improved significantly over the last four years in view of bull-run in cement prices. The balance sheets of most of the cement players in the organised segment reflect strong capitalisation, substantial amount of free cash invested in fixed deposits & mutual funds and relatively low level of gearing. An analysis of the rating of 22 cement companies in CARE's universe reveals that in FY10, CARE upgraded ratings of seven cement companies while downgraded rating only of one cement company. The upgrades were a result of significant improvement in liquidity and debt profile of the aforesaid companies backed by high profitability and cash accruals on a sustained basis.

Going forward, the margins of cement companies are likely to be in pressure. This is in view of rising coal and freight costs coupled with weakening pricing power of cement players as a consequence of significant capacity additions already done and further on the way. Cement companies are expected to experience the bottomed-out capacity utilisation in second quarter of FY11 when demand is also expected to be on lower side due to monsoons. Accordingly, FY11 will be a difficult year for the industry. The southern market would be the hardest hit as a bulk of the planned capacities is being commissioned here. This coupled with political turmoil in Andhra

Pradesh makes it the most vulnerable to pricing headwinds. While the northern, central and eastern markets will also face pressures brought on by capacity expansion, buoyant demand in these regions is likely to mitigate the supply glut. Further, rebound in demand driven by growth in the infrastructure and recovery in the real estate segment are likely to enable faster absorption of new capacities.

While there would be considerable variation in demand supply balances across the regions, the impact would differ from company to company. The player with locational advantage, strong capital structure, low cost structure and adequate backward integration would emerge stronger. In the short run, profitability of cement companies is expected to be volatile as new capacities are expected to push companies to sell at lower prices thereby affecting the margins. However, over the longer term, economic sense is expected to prevail, supporting prices and profitability. Even in the short run when margins are expected to be under pressure, cement companies are likely to post a reasonable level of profits driven by robust demand, relatively low gearing (as a result of high cash accruals in the last four years), higher industry consolidation and higher vertical integration. Consequently, CARE believes that the credit profile of cement companies is likely to remain almost stable.

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